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TO: Production Control Staff

2. Title or Subject (31)
Line 1 Poland: Assessment of Debt
Line 2 Rescheduling Possibilities
Line 3
Line 4
Line 5

3. Analyst(s) & Other Contributors (31)
Line 1
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4. Requester and Purpose (39) Stephen Larrabee
Line 1 NSC -- to assess the likelihood that
Line 2 Poland will multilaterally reschedule
Line 3 its hard currency debt.
Line 4
Line 5
Line 6

Classification (39)
[redacted]

5. Precis (39)
Line 1 Although Poland's external financial
Line 2 position vis-a-vis the West continues
Line 3 to deteriorate, it is unlikely that Poland
Line 4 will reschedule its hard currency debt on
Line 5 a formal, multilateral basis. More likely
Line 6 is a continuation of the de facto resche-
Line 7 duling that has been going on for some
Line 8 time. In any event, there would be little substantive difference between a formal rescheduling and the piecemeal refinancing and the "rolling over" characteristic of the recent past.

APPROVAL:

Branch (if less than 10 manhours) [redacted] Date 3/24/80

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Director (for special requesters) Date

Note: Numbers in parentheses indicate the maximum number of characters and blanks to be inserted in a line--i.e., (16) means no more than 16 spaces.

SECRET

APPROVED FOR RELEASE
DATE: NOV 2001

SUBJECT: Poland: Assessment of Debt Rescheduling Possibilities

TO:

SUMMARY:

[redacted]

[redacted] we do not expect that a formal, multilateral rescheduling will take place in the near future. Poland seems very reluctant to reschedule [redacted] Moreover, even though its already desperate financial position is likely to continue to deteriorate, Poland may be able to stay financially afloat without rescheduling because: (1) bankers may prefer rolling over--that is, renewing--loans as they fall due to precipitating a default or to subjecting themselves to the enormous negotiating problems involved in arranging a rescheduling; (2) Poland can probably borrow new money to finance imports, both through government-backed and strictly commercial (unbacked) loans, as exporters in the West in a period of slack world demand continue to pressure governments and bankers alike to facilitate exports to Poland; and (3) it is quite possible that the USSR would provide assistance to Poland to avoid a rescheduling that could be harmful to Soviet political interests on many counts. Finally, should Poland actually try to reschedule, there is no guarantee that the attempt would succeed. The principal obstacles to achieving an agreement acceptable to all parties include the difficulties

Western creditors would have in agreeing among themselves on terms; the fact that Poland is not a member of the IMF; and the likelihood that Poland in any event would not accept the type of economic stabilization program that its creditors would require as a condition of rescheduling.

In any event, we do not expect that Poland's external financial position or domestic economy will be much affected by whether it reschedules or not. Poland is already rolling over its debt. A rescheduling--which is basically another type of rollover, different more in form than substance--is not likely to have much substantive impact.

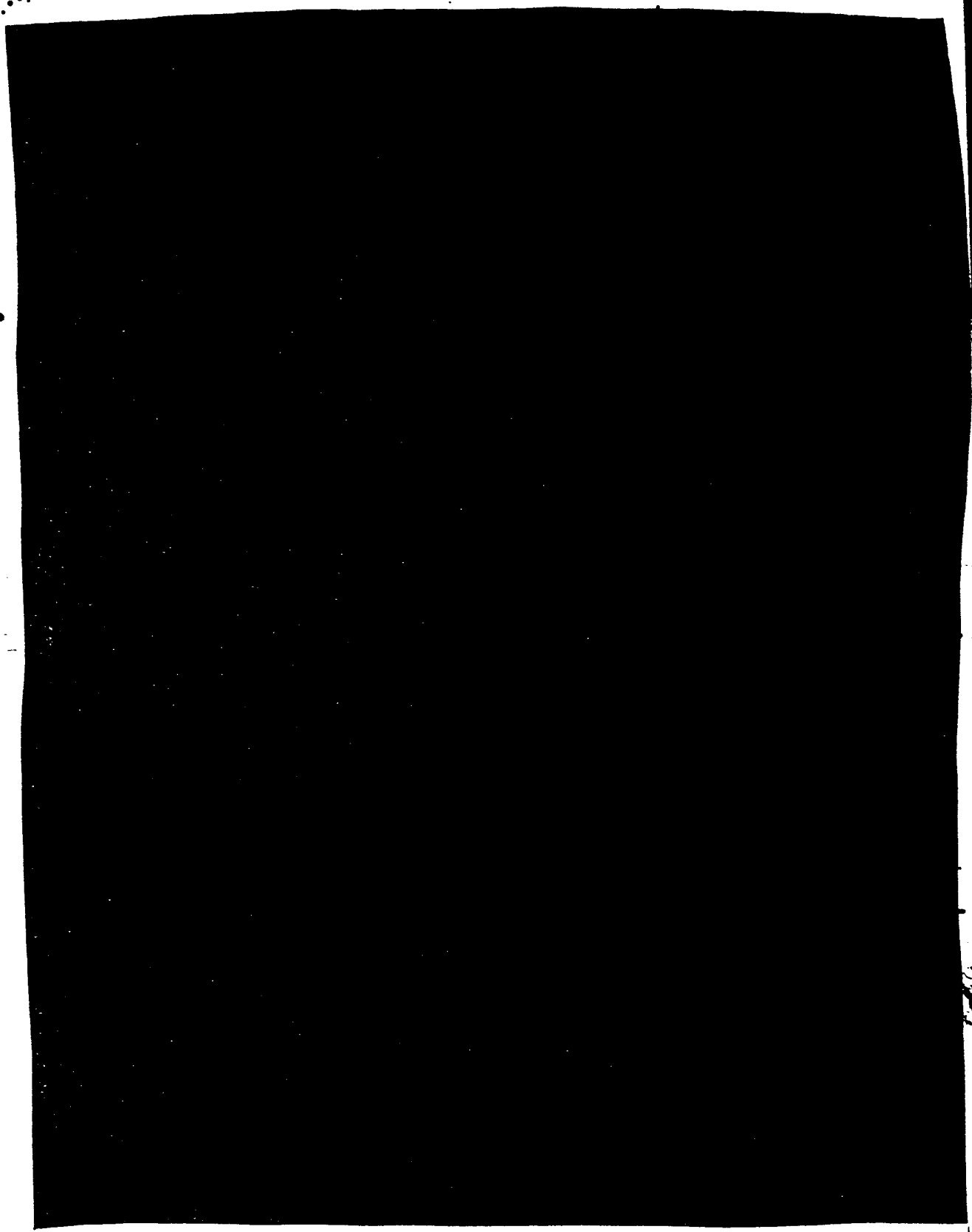
POLAND'S EXTERNAL FINANCIAL SITUATION

Poland is, indisputably, in a serious balance of payments predicament, as we explained in detail in two papers we forwarded to you on March 14--"Overview of the Polish Economy" and "Projection of Poland's Balance of Payments." To summarize briefly: Poland failed dismally in its attempt to reduce sharply its hard currency deficit in 1979. The merchandise trade deficit fell only $130 million to $1.76 billion. At the same time, the deficit on invisibles climbed by nearly $300 million as interest payments continued to rise. As a result, the current account deficit rose slightly to nearly $3 billion.

By the end of 1979, Poland's gross hard currency debt had risen to nearly $21 billion. The ratio of debt service payments to earnings from merchandise exports and invisibles jumped from 68 percent in 1978 to 77 percent in 1979. The Poles appear to have had little if any success in lengthening the maturity of their debt. Of Poland's $18 billion in medium- and long-term debt, about $9 billion falls due in 1980 and 1981. Of the $9 billion, over $6 billion is commercial debt (not government-guaranteed) and a little less than $3 billion is government-backed. In addition, Poland has a short-term debt of about $3 billion. [redacted]

Further deterioration in Poland's balance of payments is expected this year, with the borrowing requirement likely to soar to about $9 billion from $7.7 billion in 1979. Raising this sum will require strenuous efforts. Indeed, some of its recent actions--tantamount to rescheduling on a de facto, piecemeal basis--suggest extreme pressure on Warsaw to come up with the required hard currency. [redacted]

Nor does the future promise improvement. Our estimate is that, even if Poland holds real GNP growth to 1 percent a year and has reasonable success in increasing its exports, the current account deficit will continue to rise and the hard currency debt will reach $58 billion by end-1985, with a debt service ratio of over 90 percent. [redacted]



[redacted]

A FORMAL RESCHEDULING STILL SEEMS UNLIKELY

[redacted] we doubt that Poland is about to seek debt relief through an organized multilateral rescheduling. More likely is a continuation of the day-to-day, frantic, piecemeal de facto rescheduling characteristic of the last year or so. A striking example of de facto rescheduling was a recent $300 million, 8-year loan to Poland by a group of French banks. [redacted]

[redacted]

The loan--which, according to a press report, was actually negotiated by the French and Polish governments--is French-government-guaranteed but still carries commercial rates [redacted]

We believe that both Poland and the USSR prefer this ad hoc modus operandi as a politically less embarrasing alternative. Furthermore, it also appears feasible since:

--Western bankers, in a crunch, would prefer rolling over debt to outright default, with the embarassment and material damage to the banks that would entail.

--Although private banks may refuse new funds in the form of untied loans, Poland can still count on some new loans to finance its current account deficit. Poland has available sizeable Western government-backed credit lines for the purchase of machinery and equipment and other commodities. Also, Warsaw presumably will be able to obtain at least some new government-backed credits as Western governments strive to help their market-hungry exporters. Moreover, banks, likewise under pressure from customers eager to export to Poland, may extend some unguaranteed supplier credits. Powerful Western export interests, particularly in the current period of slack demand, are far more interested in selling to Poland than in restor order to Warsaw's finances. [redacted]



[redacted]

--The USSR can probably be relied on to provide some assistance in some form if a Polish balance of payments crisis appears imminent. (Indeed, there are indications that Poland is already receiving Soviet aid. Reportedly, Moscow will permit an increase in Poland's trade deficit with the USSR, a move that would facilitate increases in Poland's exports to and/or decreases in imports from the non-Communist world. There are also reports that Council of Mutual Economic Assistance financial institutions are giving direct hard currency loans, presumably at Moscow's direction, to Poland.) Moscow is probably somewhat ambivalent about rescheduling. Although no Warsaw Pact country has ever rescheduled multilaterally, the USSR may not, from a strictly economic point of view, object to rescheduling to the extent that it would spare the USSR from having to use its own resources to bail out Poland. But the USSR would be loath to accept the Western intervention in Poland's economy that a rescheduling might well involve. Indeed, the political reasons for opposing a rescheduling could well outweigh the economic reasons for supporting it in Moscow's thinking. Ideological and prestige factors would probably persuade the Soviets to provide the economic assistance necessary

to prevent a rescheduling with Western creditors. The example of a socialist state publicly appealing to Western bankers to save itself from its own economic and financial ineptitude would be a severe blow to Soviet claims of the superiority of "the socialist economic system." Furthermore, rescheduling would probably oblige Warsaw to impose restrictions on its economy at the direction of Western creditors and compromise Party control of economic policy--an ideologically unpalatable proposition. Soviet assistance to stave off rescheduling, moreover, could subject the Polish leadership to additional Soviet political pressures to alter Polish domestic policies.

RESCHEDULING ATTEMPT MIGHT FAIL

If Poland does opt for a formal, multilateral rescheduling the effort could fail, since it is by no means certain that Western lenders could work out an acceptable arrangement with the Poles.

Negotiating multilateral reschedulings is a lengthy and complicated process that has almost invariably involved participation by the International Monetary Fund. The IMF plays a vital role in several ways: by providing technical and advisory services to both debtors and creditor clubs; by setting up standby arrangements that provide financial assistance to debtor countries on the basis of austerity

programs that creditors insist on as a condition of rescheduling; and by evaluating developments in debtor countries after rescheduling to insure that conditions are being met. [redacted]

Poland is not a member of the IMF, nor--despite previous indications of interest in joining--is it likely to become one amidst the heightened East-West tensions created by the Soviet invasion of Afghanistan. Furthermore, Poland is unlikely--at Western direction--to expand or intensify the austerity measures already adopted. First, as our calculations suggest, even reducing economic growth to the point where per capita consumption ceases to rise would probably not arrest the deterioration of Poland's balance-of-payments position; further restraints on economic activity would presumably cause a perceptible drop in living standards that the regime would be unwilling to risk. Second, it is dubious that Poland would agree to a restrictive program with teeth imposed by industrialized capitalist countries. [redacted]

There are other obstacles to rescheduling. Most of the debt falling due in the next two years--which is presumably what the Poles would seek to reschedule at a minimum--is unguaranteed commercial debt. Past experience indicates that reaching agreement among creditors is much more

difficult for strictly commercial debt than for government-backed debt. Furthermore, the amount of Polish debt, commercial and government-backed, is enormous. Previous reschedulings, almost always with LDCs and almost always confined to official credits, generally have been for no more than $500 million. In the Polish case, however, several billion dollars worth of debt would certainly be included in any comprehensive rescheduling. An unprecedented $4½ billion would be involved even if only half of Poland's medium- and long-term debt due in 1980-81 were rescheduled. The huge sums involved would likely intensify the inevitable disputes among creditors on how to share the rescheduling burden equitably. [redacted]

Warsaw's private creditors, and possibly Warsaw itself, would seek to include government-backed debt in a rescheduling. This could lead to further dispute, with governments and private debt-holders arguing over the distribution of the burden. USG policy, in particular, stipulates that public and private debt must be comparably treated, meaning that the cost of debt rescheduling must be proportionally shared between the government and private sectors. [redacted]

WOULD RESCHEDULING REALLY MAKE A DIFFERENCE?

Whether or not the Poles reschedule formally or continue rolling over their debt piecemeal is not really of any substantive difference. Rescheduling is in essence a rollover

--a formal, explicit, organized, comprehensive, coordinated rollover with humiliating connotations--but a rollover nevertheless. It differs from the current rollover methods, generally known as "refinancing," that Poland is employing mainly in form. To quote one expert discussing the distinction "What is the difference between a rescheduling of debts and a new loan [which in this context refers to refinancing]? It is nearly metaphysical. The economics are the same--money is repaid later rather than now. It is the psychology which differs--a rescheduling is a confrontation, an admission of failure, an emotional catharsis, while a new loan [refinancing] is business as usual.". (David Beim, "Rescuing the LDCS," Foreign Affairs, July 1977.) [redacted]

What does matter is whether Poland can, assuming it rolls over existing debt in one way or another, raise new funds to finance its current account deficit. Its ability to conclude new borrowings does not seem to hinge on whether it reschedules or not. Success or failure in adding to its debt is a function of such variables as bankers' confidence and pressure from Western exporters on their governments and bankers, etc., which are not necessarily or even probably influenced by whether or not Poland has rescheduled. [redacted]

Inability to raise new funds would impose considerably more restraint on the Polish economy. Poland would in effect

have no choice but to balance its current account, obviously a difficult blow to absorb. However, the cut in imports this would presumably entail need not necessarily be politically destabilizing if Poland makes further cuts in capital goods purchases abroad rather than in imports of materials and consumer goods. [redacted]

The worst case of all--one that nobody would want and one that we certainly do not anticipate--would not merely be inability to raise new loans but also outright default on existing debt. Here, too, Poland would be required to balance its current account. But the legal consequences of default could seriously interfere with the normal conduct of the trade. [redacted]